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Weak Dollar Pulls Down Japanese Import Prices

American policymakers had high hopes for U.S. exports to Japan when the dollar started to drop against the yen in 1985. Their thinking was that more or less constant dollar prices would translate into lower prices in yen, leading to larger sales and more profits for American exporters. Recently, some American observers have argued that the process is not working right; somehow the benefits of the dollar's decline are not reaching the Japanese consumer in the form of lower prices so that sales, while up, are not as high as they might be. If true, this argument would parallel the complaint that Japanese exporters are not raising prices in the American market to reflect the yen's rise (see JEI Report No. 10A, March 11, 1988). Less-than-hoped-for U.S. exports to Japan would combine with the almost constant level of imports from Japan to keep the bilateral trade balance at close to its old level.

Washington may have had unrealistic expectations from the beginning. In competitive markets, firms price according to the competition; if their rivals keep prices low, they will have to follow. But if their competitors stick with high prices, they would be foolish to cut prices dramatically. For American firms selling in Japan, for example, there would be no reason to slash prices significantly if they are only second-tier suppliers of a standardized product dominated by Japanese makers; trimming prices a little should be enough to sell much larger quantities. This suggests that a large drop in the dollar is unlikely to lead to corresponding declines in the Japanese price of such American goods. In those areas where American companies face less competition from Japanese firms, larger price cuts are more likely.

Table 1 shows the extent to which foreign firms have passed through the currency changes since September 1985 in the yen prices they charge in the Japanese market. As textbook economics suggests, in many instances the full benefits have not been passed on to Japanese distributors. However, the data also show that prices in yen have fallen substantially for the products listed.

Table 1: Percent of Dollar's Decline Passed Through in Import Prices*

Product Group	September 1985-April 1988
Food	72.7%
Clothing	48.4
Organic Chemicals	49.7
Inorganic Chemicals	82.4
Steel	53.3
Aluminum and Alloys	19.2
Nonelectric Machinery	84.7
Electric Machinery	102.2
Semiconductors	73.9
Transportation Equipment	63.6
Aircraft	82.8

*The dollar declined 90.4 percent against the yen during this period.

Source: Calculated from Japan Tariff Association, The Summary Report: Trade of Japan, April 1988.

Compared to Japanese products in the United States, a large proportion of Japan's imports consists of industrial and agricultural inputs and the prices of these commodities reflect changing supply and demand throughout the world. This characteristic makes interpreting pass-through statistics more difficult. Some goods, such as aluminum, have risen in dollar price during the past year. The appreciation of the yen has not been enough to offset this; the yen price has risen as well, reflected as a negative pass-through between April 1987 and April 1988. Other goods, whose prices have dropped on world markets, show pass-throughs exceeding 100 percent. These short-run, commodity-like swings in prices tend to even out over the longer period used in Table 1.

These data are only part of the picture, however. Lower import prices, if any, may not be passed on to the consumer if the distributor increases its margins. Conversely, competition could increase or distribution costs could fall as the imports are distributed in larger quantities, leading to lower margins and more than a 100 percent pass-through of the import price drop. Japanese government data suggest that, depending on the product, both phenomena are occurring (see Table 2). While the prices of goods such as guitars have been

Table 2: Comparison of Import and Retail Price Changes, September 1985 and April 1988

Product	Reduction in Import Price*	Reduction in Retail Price*	Retail Price Change/ Import Price Change
Photographic Film	Y76	Y30	39%
Bananas	27	14	52
Guitars	82,353	50,000	61
Records	802	530	66
Umbrellas	119	90	76
Coats	6,266	5,000	80
Dress Shirts and Blouses	209	200	96
Jeans	381	400	105
Electric Razors	666	700	105
Cars	74,815	80,000	107
Tennis Rackets	4,120	4,640	113
Grapefruit	87	116	133
Handbags	340	500	147
Wine (American-made)	237	350	148
Exercise Balls	142	210	148
Compact Disks	182	300	165
Shrimp	764	1,290	169
Fountain Pens	2,717	5,000	184
Wind Instruments	19,470	36,000	185
Fans	1,500	2,820	188
Golf Clubs	24,858	48,000	193
Firecrackers	5	10	200
Tires	4,686	9,400	201
Underwear	94	200	213
Household Aluminum Articles	465	1,030	222
Toys	512	1,200	234
Canned Sweet Corn	71	200	282
Neckties	469	1,500	320
Lemons	283	927	328
Wrist Watches	2,440	8,400	344
Socks	25	100	400
Whiskey (standard)	178	775	435
Natural Cheese	76	396	521
Whiskey (premium)	321	2,350	732
Down Mattresses	13,319	110,000	826
Eyeglasses	196	5,000	2,551

*Per unit price change in yen except for food items, which are per kilogram.

Source: Nihon Keizai Shimbun, June 3, 1988.

reduced by less than the fall in import prices, other prices have been cut much more. Most dramatically, the import price of eyeglasses dropped only Y196 ($1.57 at Y125=$1.00), but the retail price plummeted Y5,000 ($40).

Adding the changes in import prices with price cuts at the retail level, the Ministry of International Trade and Industry, one of the four government agencies that conducted the pricing survey, estimated that the retail prices of goods from the United States fell an average of 26 percent during the September 1985-April 1988 period. This suggests that, for a broad array of products, U.S. and other exporters have cut their prices in the Japanese market and those lower prices are finding their way to the Japanese consumer.

Douglas Ostrom

Japanese Banks At Top But Still Scrambling

According to a special survey in Business Week, the five top banks in the world in terms of assets are Japanese. Moreover, Japanese banks occupy seven of the top 10 positions and account for 21 among the top 50. Nevertheless, Japanese banks are scrambling to comply with tough capital-to-asset ratios set by the Bank for International Settlements in an attempt to even the playing field in global banking and to enhance the soundness of banks around the world. Japanese banks are instituting new policies, such as tightening up on poorly performing loans and issuing large amounts of new shares, that will have an impact on the Japanese banking system and financial market.

According to the Business Week study, three factors combined to improve the positions of Japanese banks between 1986 and 1987. Their assets, measured in dollars, were magnified by the yen's appreciation last year. The resurgent Japanese economy, combined with steady inflation and gradual interest rate liberalization, led to higher net income. In addition, U.S. banks took large write-downs and set aside even bigger reserves for loans to developing countries, both of which dented profits. After taking into account the differences in national accounting practices and portfolio structures, the study concludes that the "real profitability" of Japanese banks was average in 1987. This runs counter to the often heard complaint that Japanese banks pursue market share rather than profit.

Nevertheless, Japanese banks are concerned over the BIS guidelines. Under the December 1987 BIS requirements, commercial banks in all member countries must raise their core capital (common equity capital and disclosed reserves) to 4 percent of total assets; total capital (core capital plus 45 percent of the current market value of stocks and bonds or other hidden reserves) must be at 8 percent by 1992. Japanese banks' core capital ratios range from 2 percent to 3.5 percent; their total capital ratios are between 4 percent and 6 percent. Under transitional rules, banks must attain levels of 5 to 6 percent for core capital and 7.25 percent for total capital by the end of 1990. Japanese banks are taking several approaches:

- Issuing new stock or convertible debt instruments to increase shareholder equity. Dai-Ichi Kangyo Bank, Ltd. issued 40 million shares in September 1987, a record broken by the Bank of Tokyo, Ltd. this April when it offered